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IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

LEONARD BRAWER,

Petitioner,

vs.

THE OPTIONS CLEARING CORPORATION and AMERICAN STOCK EXCHANGE, INC.,

Respondents.

REPLY TO JOINT BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

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The petitioner respectfully submits this reply to address five points raised by the respondents in their joint brief.

1. Timeliness of the § 17A Issue

At page 21 of their brief they assert that the petitioner's argument that § 17A limits the discretion of SROs and precludes a fraud or bad

faith standard is raised "for the first time in his Petition in this Court." Of course, as the respondents should be aware, in my reply brief in the Second Circuit, at page 18, I raised the point that prompt and accurate clearance and settlement were required by § 17A, and at oral argument I argued that it precluded a fraud standard. In addition, I argued the point again in my petition for rehearing in the Second Circuit. Accordingly, the suggestion that this argument comes too late should be rejected.

2. The Discretion Allowed in the Adjustment Rule

The respondents argue that article VI, § 11 of the OCC's bylaws give it unfettered discretion to make adjustment decisions and that since the S.E.C. has approved the bylaw, the

requirement of accuracy contained in § 17A is overridden. Of course, it is an elementary principle of law, typically applied to corporate bylaws and charters, that provisions contained therein are void if they purport to extend authority beyond that permitted by statute. Brooks v. State, 79 A. 790, 800-01 (Del. Supr. 1911). Similarly, I submit that here, even the approval of the S.E.C. fails to empower SROs' bylaws to grant discretion beyond that contemplated by statute.

The respondents, p. 22 n. 11, also note that the Second Circuit "emphatically rejected" the argument that the language of article VI, § 11 did not give the broad discretion claimed by the respondents. So it did, but I submit that its conclusion was based on a misreading of that bylaw. My argument was contained

in the reply brief, and I enclose the relevant portion in the appendix to this brief together with the complete text of article VI, § 11.

3. The Effect of the S.E.C.'s Position

The respondents contend, p. 20 n. 10, that it is "noteworthy" that the S.E.C. supported their position in the Second Circuit. I submit that under the instant circumstances where the position of the S.E.C. concerns the existence of a private right of action and where the S.E.C.'s position is not one which has been long and consistently held, the S.E.C.'s view is entitled to little if any weight. Piper v. Chris-Craft Industries, Inc., 430 U.S. 1, 41 n. 27 (1976).

4. The Troublesome and Close Question

The respondents argue at p. 24 of their joint brief that it is the

petitioner who claims that the issue of fraud or bad faith is "close." As they will recall, it was the Second Circuit that called it "close," and "troublesome" as well. See the appendix to the petition at A-14.

Contained in this close and troublesome issue is the question just who made this decision and how and why. Was it indeed minor functionaries, as the respondents seem to characterize them, Resp. Bf. at page 5, (if the OCC's chairman can be so characterized), or was it more powerful forces? After all, the chairman of the OCC, who is supposedly in charge of this process did not convene the committee but was told to be at his telephone to participate.

5. The Wide Scope of Writs of Certiorari

The respondents contend, at pages

8-9 of their brief, that this court should decline to grant the writ on the question of the continued vitality of Baird v. Franklin, 141 F.2d 238 (2nd Cir.) cert. denied 323 U.S. 737 (1944) on the grounds that the Second Circuit also expressly declined. Of course, when granting a writ of certiorari this court can decide all substantial federal issues determined below. Mercer v. Theriot, 377 U.S. 152, 153-54 (1964). The cases cited by the respondents are inapplicable in that in those cases this court declined to decide questions not raised on appeal below. However, in one case they cite, J. Truett Payne Company, Inc. v. Chrysler Motors Corporation, 451 U.S. 557, 568-69 (1981), this court vacated the judgment of the court of appeals and remanded for it to pass upon the undecided issue.

IN SUMMARY: CONFLICTS, REAL AND IMAGINED

In opposing this petition, the respondents have sought to create the illusion of harmony in the lower courts when in fact those courts are riven with conflict and doubt upon the questions presented by the petitioner.

Similarly, the respondents have sought to promote the appearance of conflict where there is none, such as upon the question whether there is any serious dispute as to whether Phillips Petroleum underwent a recapitalization. As near as I can tell, the respondents' position that it was not a recapitalization is based on the contention that it was instead an exchange offer, relying upon the discredited theory that "pigs is pigs." R.H. Johnson & Co. v. SEC, 198 F.2d

690, 696 (2nd Cir.) cert. denied 344 U.S. 855 (1952). However, since they have yet to offer any explanation (let alone a persuasive one) as to why an exchange offer by an issuer for its own stock must not of necessity also be a recapitalization, as held in the cases I cited in the petition, p. 26, I submit that there is no genuine issue here.

CONCLUSION

The petition for writ of certiorari should be granted, and the judgments below should be reversed.

Respectfully submitted

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Dated: June 19, 1987

APPENDIX

The following is reprinted from pp. 15-18 of the petitioner's reply brief in the Second Circuit:

The OCC and Amex also rely upon the argument that the adjustment rule gives them "the 'sole' discretion to determine when to make an adjustment upon the occurrence of certain events." Ans. Bf. p. 44. The SEC uses the phrase "complete discretion." SEC Bf. p.11.

Their argument fails in analysis. In the main brief, at p. 28, I noted that the adjustment rule said that adjustments "shall" be made and suggested that the word "shall" means "must." That is the usual meaning of "shall." Words and Phrases, "Shall." The word is mandatory unless the contrary "clearly appears." 1A Sutherland Stat Const §25.04 (4th ed. 1985). For example, it has been held not

mandatory for inconsequential time periods, Village of Park Forest v. Fagan, 356 N.E.2d 59 (Ill. 1976), and to avoid unconstitutional constructions. Neither the OCC, the Amex, nor the SEC has refuted or even attempted to explain any reason why the usual meaning of "shall" should be abandoned.

A detailed review of the adjustment rule, §11 of Art. VI of the OCC's bylaws, confirms that the usual rule obtains here. The preambular language of §11 provides that whenever any of the listed events occurs (e.g., stock split, distribution, recapitalization, etc.) the option "shall be adjusted," by adjusting either the number of contracts, trading unit, or exercise price. In subsections (a) and (b) dealing with stock dividends, splits, etc., the adjustment

"shall" be made, and, so far, §11 provides for no discretion of any kind. Discretion first appears in subsection (c), dealing with capital or liquidating distributions or distributions of new classes of stock. It states that "the Securities Committee ... shall determine whether an adjustment is appropriate...." If that committee determines that an adjustment is appropriate, subsection (c) further provides that "either" the exercise price or the trading unit "shall be" adjusted, and, if it is to be the exercise price, "the Securities Committee ... shall determine the value of the distributed property."

I suggest that subsection (c) works in the following way. If a corporation declares the distribution of a new class of preferred stock to the holders of its common, in the

ratio of one share of preferred for one share of common (which common is the underlying stock of a listed option), the committee will first decide whether to adjust. In this they have discretion, but presumably they will ordinarily adjust if the ex date falls before the expiration date, but not after. If they decide to adjust, they next decide how to adjust. They can either decide that the exercise of the option requires delivery of one share of new preferred with each share of old common or that the exercise price shall be reduced by the value of the new preferred. They have the discretion to decide upon one or the other, but they have no other choice and no middle ground; i.e. they cannot do a little of both. If they decide to reduce the exercise price the subsection requires them

to make a separate determination of the value of the new preferred share.

Subsection (d) covers the instant case. It deals with the event of a "reorganization, recapitalization, reclassification or similar event." It provides:

> "the Securities Committee shall make such adjustments in the exercise price, trading unit or number of contracts ... as that Committee in its sole discretion determines to be fair...."

The language "sole discretion" in this subsection (d) refers only to the kind of adjustment and not to whether to adjust. With the exception of subsection (c), concerning distributions, the adjustment requirement is expressed in the imperative mood, i.e., it everywhere else says that an adjustment "shall" be made. In subsection (c), however, it says the committee "shall determine <u>whether</u>"

to adjust, but no such similar language appears in subsection (d). In subsection (c) the committee has discretion as to how to adjust but only as between two mutually exclusive methods. By contrast in subsection (d) the committee has three choices and can select any combination or middle ground. For example, in the instant case, where the Phillips stockholders received three different bonds for their stock, the committee could have either adjusted the trading unit, adjusted the price, or adjusted the trading unit for one bond and the price for two bonds or done it some other way. To express this wide range of choice as to how to adjust, subsection (d) says "sole discretion." If it were meant to give the committee discretion as to whether to adjust, the language would say that the committee "shall determine

whether" to adjust, the same as it does in subsection (c).

I submit that this construction of subsection (d), concerning recapitalizations, is consistent with the balance of the rule and with its purposes.

Article VI, § 11 of the OCC Bylaws:

Whenever there is declared a stock dividend, stock distribution, stock split or reverse split, rights offering, distribution, reorganization, recapitalization or reclassification or similar event in respect of any underlying security, the number of outstanding option contracts, the unit of trading and/or the exercise price with respect to all option contracts open for trading in that underlying security shall be adjusted, effective on the "ex-date" of the underlying security in the primary market, in accordance with

this Section 11. The adjusted exercise price shall be rounded to the nearest 1/8 of a dollar and the adjusted trading unit shall be rounded down to eliminate any fractional share. No adjustment shall be made for cash distributions made out of "earnings and profits" as that term is used in the Federal Internal Revenue Code.

(a) In the case of a stock dividend, stock distribution or stock split whereby one or more whole numbers of shares of the underlying security are issued in respect to each outstanding share, each option contract covering that underlying security outstanding prior to such event shall be increased by the same number of additional option contracts as the number of shares issued with respect to each share of the underlying security, and the exercise price per share in effect

immediately prior to such event shall be proportionately reduced. The unit of trading with respect to each option contract shall remain the same.

(b) In the case of a stock dividend, stock distribution or stock split whereby other than a whole number of shares of the underlying security is issued in respect of each outstanding share, the exercise price in effect immediately prior to such event shall be proportionately reduced, and conversely, in the case of a reverse stock split or combination of shares, the exercise price in effect immediately prior to such event shall be proportionately increased. Whenever the exercise price with respect to an option contract has been reduced or increased in accordance with this paragraph (b), the unit of trading with respect to the option contract shall be proportionately

increased or reduced, as the case may be. If an adjusted unit of trading is rounded down to eliminate a fractional share, the adjusted exercise price shall be further adjusted, to the nearest 1/8 of a dollar, to reflect any diminution in the value of the option contract resulting from the elimination of the fractional share. No adjustment in the number of option contracts outstanding shall be made on account of happening of any of the events for which adjustments are provided in this paragraph.

(c) In the case of any distribution made with respect to shares of underlying securities, other than cash distributions of the character referred to in the third sentence of this Section 11 and other than distributions for which adjustments are provided in paragraphs (a) or (b) of this Section

11, the Securities Committee of the Corporation (as hereinafter defined) shall determine whether an adjustment is appropriate by reason of such event in the interest of fairness to holders and writers of options contracts. Whenever an adjustment is so determined to be appropriate, either (i) the exercise price in effect immediately prior to such event shall be reduced by the value per share of the distributed property, in which event the trading unit shall not be adjusted, or (ii) the trading unit in effect immediately prior to such event shall be adjusted so as to include the amount of property distributed with respect to the number of shares of the underlying security represented by the trading unit in effect prior to such adjustment, in which event the exercise price shall not be adjusted. The

Securities Committee shall determine whether a given event for which adjustment is provided under this paragraph shall result in an adjustment under clause (i) or clause (ii) of the preceding sentence, and, with respect to adjustments under clause (i), it shall determine the value of the distributed property.

(d) In the case of any reorganization, recapitalization, reclassification or similar event with respect to shares of underlying securities for which adjustment is not provided in any of the foregoing paragraphs of this Section 11, or in the case of any event for which adjustment is provided in one of the foregoing paragraphs but is not considered by the Securities Committee to be appropriate under the circumstances, the Securities Committee shall make such adjustments

in the exercise price, trading unit or number of contracts with respect to the option contracts affected by such event as that Committee in its sole discretion determines to be fair to the holders and writers of such option contracts.

(e) The Securities Committee, in exercising its functions pursuant to paragraphs (c) or (d) of this Section 11 regarding adjustment of option contracts in an underlying security, shall consist of two designated representatives of each Exchange on which option contracts in that underlying security are open for trading and the Chairman of the Corporation. The vote of a majority of the voting members of the Securities Committee shall constitute the action of the Committee. The Chairman of the Corporation shall not be a voting member

of the committee except in the case of a tie vote, in which case the Chairman shall have the right to cast a vote to break the tie and shall, for such purpose, be deemed to be a voting member. The members of the Securities Committee need not be Clearing Members or officers or directors of the Corporation. The Securities Committee may transact its business by telephone.